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IN THE

Supreme Court of the United States

October Term, 1968
No. [redacted] 183

A. J. INDUSTRIES, INC.,

Petitioner,

vs.

THE UNITED STATES.

Petition for a Writ of Certiorari to the United States Court of Claims.

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To the Honorable, the Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

Petitioner, A. J. Industries, Inc., prays that a writ of certiorari issue to review the opinion and judgment of the United States Court of Claims in this case.

Opinion Below.

The Opinion, Findings of Fact and Conclusion of Law of the Court of Claims, reported at 388 F.2d 701, appear in Appendix A to this Petition.

Jurisdiction.

The decision and judgment of the Court of Claims was entered on December 15, 1967. A timely motion for rehearing filed by petitioner was denied by order of the court entered on March 15, 1968. The jurisdiction of this Court is invoked under 28 U.S.C. 1255(1).

Questions Presented

Petitioner was denied an income tax deduction under Section 165(a) of the Internal Revenue Code for a loss which it claimed was sustained in 1958 when it abandoned the underground workings of its gold mine in Juneau, Alaska. The Court of Claims held no deduction was allowable on the ground that the mine "became worthless prior to 1958." This raises the following questions:

1. When does a taxpayer sustain a "loss," within the meaning of Section 165(a) of the Internal Revenue Code, with respect to a non-depreciable business asset which the taxpayer abandons because it is no longer useful in his business as the result of a change in business conditions?

(a) What is the proper test for determining when the asset has lost its usefulness in the taxpayer's business, so that he is required to abandon it and/or claim his loss?

(b) Is the loss sustained and deductible only in the year in which the asset first loses its usefulness, regardless of when it is abandoned or whether it is abandoned at all?

(c) Must the taxpayer carry out the abandonment and/or claim his loss as soon as the asset loses its *present usefulness,* even though he believes it has sufficient *potential value* to warrant its retention on the chance that conditions will change to make it useful again?

2. In view of the Court of Claims' own rules regarding liberal construction of refund claims, and the mitigation provisions contained in Sections 1311, *et seq.* of the Internal Revenue Code relating to a deduction incor-

rectly claimed by a taxpayer in one year but allowable in a different year, was the court under a duty to determine whether petitioner's loss was sustained in 1956 or 1957, if not 1958?

Statutes and Regulations Involved.

This case involves the Internal Revenue Code of 1954, Sections 165(a) and 1311-1314, together with the applicable Treasury Regulations. The relevant portions of the Code and Regulations are set forth in Appendix B to this petition.

Statement.

A. The Essential Facts Establishing the Loss.

The following facts are believed essential to an understanding of the questions raised herein. They are not in dispute.

Petitioner (formerly the Alaska Juneau Gold Mining Company) operated a gold mine in Juneau, Alaska, from 1897 until 1944. [F. 3.][1] In 1944, the mine was shut down because wartime conditions and the fixed price of gold made it impossible to operate at a profit. [F. 21-25.] However, petitioner's management and the goldmining industry in general were confident that conditions would improve after the war, and that the price of gold would be increased to make mining profitable again. In the meantime, petitioner's management attempted to preserve its mining assets for future use. [F. 28, 42; Rep. Vol. I, p. 161; Vol. II, p. 4.]

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[1]The designation "F." refers to the Findings of Fact of the Court of Claims which are set forth in Appendix A to this petition. "Stip." refers to the Stipulation of Facts which was incorporated into the Reporter's Transcript in Volume I, pp. 11-26. "Rep." refers to the Reporter's Transcript which is in three Volumes.

Between 1944 and 1956, conditions grew worse rather than better. Nevertheless, at the start of 1956, a majority of petitioner's management, all of whom had long been connected with the gold mining industry, continued to believe the Juneau mine was a potentially valuable asset which they were obligated to protect for petitioner's stockholders. They still hoped Congress would increase the price of gold. [F. 28, 42, 46.][2]

During 1956, however, a proxy contest resulted in a shift of petitioner's control to the victorious insurgents who campaigned on a program of diversification. [F. 45-47.] After assuming control in June of 1956, new management began to discuss the question of whether they should abandon any further preservation of the mine and write off the substantial investment in mining assets still being carried on the company's books and financial statements. [F. 60-70.] However, they believed they should move cautiously. Among other considerations, petitioner's management feared an immediate write-off of the mining assets might cause a delisting of the company's stock from the New York Stock Exchange to the serious detriment of the stockholders. [F. 71.]

Two independent professional appraisals were ordered by new management; one was received in late 1957 and the other in early 1958. They confirmed the opinion of two mining experts on petitioner's Board of Directors that it was unlikely there would never be a large enough increase in the price of gold to enable the Juneau

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[2]A chronology of the post-war gold movement in the United States was set out in petitioner's reply brief to the Court of Claims, along with abundant authority to the effect that the court could take judicial notice of these historical occurrences. As shown there, agitation for gold reform occurred repeatedly throughout this period and was still going on as late as 1958.

mine to become profitable again—and if such increase did occur it would be too distant and was not worth waiting for. [F. 61-63, 66-68, 75, 85, 86.]

By October of 1958, petitioner had acquired sufficient assets from corporate acquisitions to remove the risk of a stock exchange delisting if the mining assets were written off. [F. 72, 73, 75.]

In December of 1958, on the recommendation of petitioner's president, the Board of Directors adopted resolutions directing the officers to abandon the investment in the underground workings of the Juneau mine. [F. 75, 76.] Following such resolutions, petitioner's president instructed the general manager at Juneau to stop maintaining the mine, and petitioner's capitalized development costs were written off as of December 31, 1958. [F. 77, 80.]

It was stipulated by the parties that if the court found there was an abandonment of the underground workings of petitioner's Juneau mine in 1958, the amount of the loss realized by petitioner would be measured by the adjusted basis of petitioner's capitalized development costs. [Stip. Para. 21.][3]

B. The Facts Establishing Petitioner's Claim.

Petitioner claimed a deduction in the amount of approximately $2,032,379.85 in its 1958 corporate return, representing the loss sustained on the abandonment of the mine. The deduction created a net operating loss. The disallowance of the deduction by the Commissioner of Internal Revenue and elimination of the net operating loss resulted in deficiencies of tax and interest ag-

[3]The correct amount of the adjusted basis of petitioner's capitalized development costs was also in dispute in the proceedings below. However, the court did not reach this question.

gregating $958,692.93 for the years 1957, 1958 and 1959. [Stip. paras. 5-7.]

Petitioner paid the deficiencies and filed timely claims for refund. Following denial of the claims by the Commissioner of Internal Revenue, petitioner commenced this suit in the United States Court of Claims which had jurisdiction by virtue of 28 U.S.C. 1491. [Stip. paras. 8-9.]

C. The Decision of the Court of Claims.

The case was tried before a Trial Commissioner. The court adopted his recommended Opinion, Findings of Fact and Conclusions of Law without modification except for the deletion of one finding which is not relevant to the issues presented in this petition.

The court held petitioner was not entitled to recover on the ground that its Juneau mine became "worthless" in a year prior to 1958. The prior year in which the loss was sustained was not specified in the decision. However, questions and comments from the court during oral argument, and its findings, indicate that it did not believe the loss occurred for tax purposes prior to the change in petitioner's management in 1956. [Ultimate Findings of Fact 105-110, Appendix A.]

Petitioner moved the court for a rehearing to seek clarification as to the year in which the loss was sustained. Petitioner's brief in support of the motion pointed out that it was of utmost importance that the decision specifically determine whether the loss was sustained in the years 1956 or 1957. If the loss was sustained in either of those years, petitioner is entitled to claim the deduction in the proper year under the express provisions of Sections 1311, *et seq.* of the Internal Revenue Code.

The motion for rehearing was denied.

Reasons for Granting the Writ.

This case raises important questions of tax law which have never been passed upon by this Court. So far as petitioner's research discloses, the United States Supreme Court has never decided a case involving an abandonment loss under Section 165(a) of the 1954 Internal Revenue Code or its predecessors under prior Revenue Acts. Petitioner believes the principles involved are of such significance to taxpayers engaged in business and to the Government in the collection of Internal Revenue taxes that they should be considered and settled by this Court regardless of the merits of the lower court's decision.

Furthermore, the decision of the Court of Claims adopted an interpretation of the law which is inconsistent with a long line of other Federal decisions and flatly contrary to the applicable Treasury Regulations. More important, it is not based upon sound analysis or reasoning and creates a "test" for determining the year of deduction of a loss under Section 165(a) which is unfair, if not unworkable. It will undoubtedly lead to widespread uncertainty and extensive litigation. Ultimately, it will cause many taxpayers to suffer harsh and unjust forfeiture of the right to deduct a loss they actually sustained, as occurred in the instant case.

To begin with, the court made a fundamental error as to the nature of a loss on business assets and when and how it is sustained within the meaning of Section 165(a). The effect of its holding is that the loss is sustained by reason of an asset becoming "worthless" and is deductible only in the year in which it becomes worthless, regardless of when it is abandoned or whether it is abandoned at all. This is contrary to nu-

merous Federal decisions. See, *e.g., United States v. Huntington Laboratories,* 82 F. 2d 356 (7th Cir. 1936); *Mine Hill & Schuylkill Haven R. R. v. Smith,* 184 F. 2d 422 (3rd Cir. 1950); *Talache Mines v. United States,* 218 F. 2d 491 (9th Cir. 1954); *Walsh v. United States,* 163 F. Supp. 421 (D. Neb. 1958); *Hummel v. United States,* 227 F. Supp. 30 (N. D. Cal. 1963); *I. Lewis Corp.,* T. C. Memo 1963-13, 22 T.C.M. 35 (1963); *Emma C. McIlwaine,* 11 T.C.M. 964 (1952); *Portland General Electric Co.,* 6 T.C.M. 1165 (1947); *W. B. Davis & Son, Inc.,* 5 T.C. 1195 (1945); *Empire District Electric Co.,* 4 T.C. 925 (1945); *Colorado and Utah Coal Co.,* 26 B.T.A. 588 (1932); *Tennessee Consolidated Coal Co.,* 24 B.T.A. 369 (1931); *White Starr Line,* 20 B.T.A. 111 (1930).[4]

These cases demonstrate that abandoment is critical—the *sine qua non* which supplies the indentifiable event necessary to fix the loss. The taxpayer must either permanently discard the asset, or discontinue the business in which it is used. The asset's loss of usefulness, based upon the business judgment of the taxpayer, is merely the circumstance which causes him to take the affirmative action; and until he does so, his loss is not fixed and he is not entitled to a deduction.

This principle was made abundantly clear by Treasury Regulation 118, Section 39.23(e)-3(a), which was in effect during the years in question. It expressly states that when an asset is abandoned because it lost

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[4]Two other contra authorities are the Court of Claims' own decisions in *S. S. White Dental Mfg. Co. v. United States,* 55 F. Supp. 117 (Ct. Cl. 1944) and *Hazeltine Corp. v. United States,* 170 F. Supp. 615 (Ct. Cl. 1959). Although the decision in the instant case is totally inconsistent with the rationale of those decisions, the court did not overrule or disapprove them or explain the inconsistency.

its usefulness in the taxpayer's business, "he may claim [the] loss for the year in which he takes such action."

The Court of Claims incorrectly held that this Regulation was superseded retroactively by Regulation Section 1.165-2, adopted in 1960. The new Regulations expressly gave petitioner the option to use the existing Regulations. Reg. Sec. 1.165-1(d)(4). But even under the new Regulation, the result should be the same. Although Regulation Section 1.165-2 states that the loss is "not necessarily" sustained in the year of *overt* action by the taxpayer, this must be limited to rare situations where the taxpayer covertly abandons the asset in an earlier year but purports to do so again in a later year for the sole purpose of postponing his deduction. To be consistent with the many decisions holding that mere non-use of an asset does not establish a loss, the determination must ultimately turn on the taxpayer's ascertainable intent.

It cannot be disputed from the court's findings that petitioner's management did not intend to abandon the underground workings of its mine until 1958. [See, *e.g.*, F. 42, 46, 71-73, 75.] The test adopted by the Court of Claims ignores the element of intent.

It is apparent from the court's opinion that it regarded losses under Section 165(a) as analogous to losses on worthless securities and worthless debts. It cited this Court's decision in *Boehm v. Commissioner*, 326 U.S. 287 (1945), and other worthless security and debt cases, for the proposition that "worthlessness" in fact is the critical factor and is to be determined by an objective test rather than a subjective one. But those decisions and their rationale are not properly ap-

plicable to abandonment losses. The loss on securities or debts is sustained solely by their becoming worthless under the express language of the respective code sections involved (Sections 165(g) and 166). Moreover, the nature of a loss on worthless debts or securities is quite different from the nature of a loss on assets used in a business. Whereas the *Boehm* rule works no injustice when applied to debts or securities, it is most unfair when applied to business assets.

A debt or security is merely a claim for money or property, a chose in action. When the claim becomes uncollectible (*i.e.*, worthless), which can be determined objectively, its holder immediately sustains a permanent loss of his investment. No action on his part is necessary to establish the loss, nor can he prevent it. It is incurred solely by reason of the claim becoming worthless, which occurs automatically at a given point in time, regardless of the taxpayer's intent, personal judgment, belief or discretion.

By contrast, the events which fix the loss of the taxpayer's investment in business assets are to a great extent within his own control. The question of whether an asset is useful to a particular trade or business or whether a particular business should be discontinued depends largely on the personal business judgment and discretion of the manager of that business.[5] He may recognize that an asset has no present value but feel that it has potential value so that he wants to retain it indefinitely on the possibility that he might be able to use it in the future. So long as he does, he cannot properly be said that he has suffered a permanent

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[5]See *S. S. White Dental Mfg. Co. v. United States, supra.*

loss of his investment.[6] It should be immaterial whether he happens to be more optimistic about the asset's potential value than other businessmen—it is his business and his assets.

Obviously, opinions of reasonable businessmen may well vary as to whether an unproductive asset should be discarded or retained for possible future use. Since no one can tell except from hindsight which judgment is correct, the tax law should not be construed as permitting the Government to substitute its business judgment for that of the particular taxpayer. Otherwise, taxpayers will be forced to discard business assets which they still believe have potential value, or risk the possible forfeiture of their right to ever claim a deduction for the loss of their investment if history does not vindicate their optimism.

For these reasons, a loss under Section 165(a) should only be deductible when the taxpayer has actually abandoned the asset, unless other identifiable events so establish the taxpayer's intent to treat his investment as irrevocably lost that overt acts of abandonment would be superfluous. The fact that the asset actually loses its value in a year prior to the one in which the taxpayer decides to give it up should be immaterial. Nor should it even matter if the taxpayer has reason to believe he will eventually have to discard it, but puts off doing so because of other bona fide business considerations. So long as it does not appear that his delay in discarding the the asset was clearly unreasonable, he should not lose the benefit of a tax deduction for the loss which he did in fact incur.

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[6]See *I. Lewis Corp., and Hazeltine Corporation v. United States, supra.*

Finally, even if this Court should conclude that the lower court correctly stated the law in its decision, it is respectfully submitted that the writ should be granted because of what the lower court did not state. The court's reasoning and ultimate findings of fact appear to place the loss in either 1956 or 1957. This would also be consistent with the court's apparent position during oral argument that it did not question the judgment of petitioner's management prior to the change in control which occurred in mid-1956. But the court's failure to fix the precise year of the loss may have serious consequences.

If the loss was in fact sustained in either 1956 or 1957, it was properly deductible at that time under Section 165(a) and should have been allowed by the Commissioner of Internal Revenue in the proper year. Sections 1311, *et seq.* of the Internal Revenue Code expressly give petitioners one year after the court's decision becomes final in which to file new refund claims to obtain the deduction in the right year, if such year was not barred at the time the deduction was claimed in 1958. Hence, both 1956 and 1957 are still open years. (See Reg. Sec. 1.1312-4(b) (Example 1) which is squarely in point.)

Obviously, therefore, it is of vital importance that the correct year of petitioner's loss be determined with precision in this litigation. Otherwise, petitioner will be forced to take its chances based upon what appears to be the court's decision, and will undoubtedly end up litigating most of the very same facts a second time. Under such circumstances, it is submitted the court had a duty to clarify its decision when requested to do so by petitioner on motion for rehearing. Its refusal to com-

ply with such a simple request not only works a serious hardship on this petitioner, but may well frustrate the entire purpose for the mitigation provisions.[7]

Indeed, petitioner believes the court's own decisions in the cases of *Pearl Assurance Co. v. United States,* 324 F. 2d 512 (Ct. Cl. 1963); *Harlan v. United States,* 312 F. 2d 402 (Ct. Cl. 1963) required it to consider the years 1956 and 1957 as alternate years for the deduction based upon the *existing* refund claims. Since the Government's own audit and Statutory Notice of Deficiency (Joint Exhibit 7) actually considered all years prior to 1958, and expressly rejected the loss deduction in any of those years, the present refund claims should be sufficient to raise all years which would be affected by a net operating loss resulting from the loss on the mine.[8]

Conclusion.

For the foregoing reasons, the petition for a writ of certiorari should be granted. A review is necessary to correct a serious misconstruction of federal tax law and to prevent a manifest injustice to this petitioner.

Respectfully submitted,

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[7]*Mertens, Law of Federal Income Taxation,* points out in Section 14.08a that the harshness caused by the disallowance of worthless security and debt losses after extensive litigation, by which time the proper year had become barred, was one of the principal factors which moved Congress to add to the Code what is now subdivision 4 of Section 1312.

[8]No refund claim was filed and none is necessary for 1956 and earlier years. Refund Claims are required only for years in which a tax was paid which the taxpayer seeks to have refunded. No tax was paid for 1956 or earlier years.